Integrating Supply Chains from Business Combinations: Principles and Best Practices of Mergers and Acquisitions

Principles and Best Practices of Mergers and Acquisitions

Gene Tyndall
EVP, Global Supply Chain Services
Tompkins Associates

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www.tompkinsinc.com

Introduction

Interactions with executives across many industries indicate not only a pent-up demand for acquiring or otherwise combining with other businesses, but also an increasing interest in doing so. With undervalued assets continuing somewhat into 2010 – and many companies holding onto capital – this is the perfect time for increased M&A activity.

The overriding challenge for supply chain managers is how to prepare for this heightened likelihood, as well as respond to it. During the late 1990s and early 2000s, when M&A activity was at its peak, supply chains were too often treated as afterthoughts. Supply chains were not always on the primary integration agenda, and managers were commonly told to integrate the respective supply chains quickly and cheaply and to focus only on cost reduction synergies and the required controls.

Today, we can likely expect different types of executive directions and quite possibly a different perspective on M&A evaluations. First, we should expect more companies to focus greater attention on the fundamental drivers of value. During the last decade, business executives have learned more about global sourcing, international sales and distribution, supply chain agility, and even overall supply chain value. This awareness should encourage M&A executives to consider not just cost reductions, but also the supply chain value creation potential for executive agendas targeting profitable growth.

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One of the chief challenges in M&A supply chain integration is to ask the right questions" upfront. The strategic questions today, then, with regard to M&A and supply chains will more likely be:

- Is the potential combination accretive from the perspective of supply chain contributions to operating margins?
- What competitive advantages will the combination yield with customers, suppliers, or other stakeholders?
- What type of supply chain disruptions in our markets and in our sourcing processes might there be as a result of the combination?
- How long, and what is involved, in the appropriate degree of integration of the respective supply chains?
- What are the synergies for cost savings, and also in enabling profitable growth?

These questions were rarely asked before, or if so, not in a timely manner. In fact, during the Tompkins Supply Chain Leadership Forum in 2009, when Jim Tompkins and I chaired a session on M&A, many industry executives stated that they were still not being brought in early enough on the planning and evaluations of potential combinations.

This paper presents many of the principles and best practices that should be adopted with regard to integrating supply chains, whether prior to, during, or following the closing of a merger, acquisition, or other business combination. It is based on: the substantial collective experience of Tompkins Associates in serving client companies involved in M&A; on industry experiences shared and learned through the Supply Chain Consortium; and on my personal experience as a recent Board Director of a FORTUNE 500 corporation that underwent a substantial business combination in 2006-07, with major supply chain integration.

First, Business Strategies

No supply chain integration should be planned or implemented without a clear definition and understanding of the business strategy for the new company. There are too many strategic variables that will affect the focus, scope, and timing of integration, and these must drive the overall process. For example:

- Is the strategy to compete as the low-cost supplier, high-service provider, or both?
- How will this vary by geographic or customer markets?
- Will the new company enter new markets, or new channels?
- Will there be a focus on new products and their rapid introductions?
- What are the growth plans for the combined business? How are supply chains expected to enable these?

The key steps, at a high-level, to take in supply chain integration can be seen in *Figure 1*.

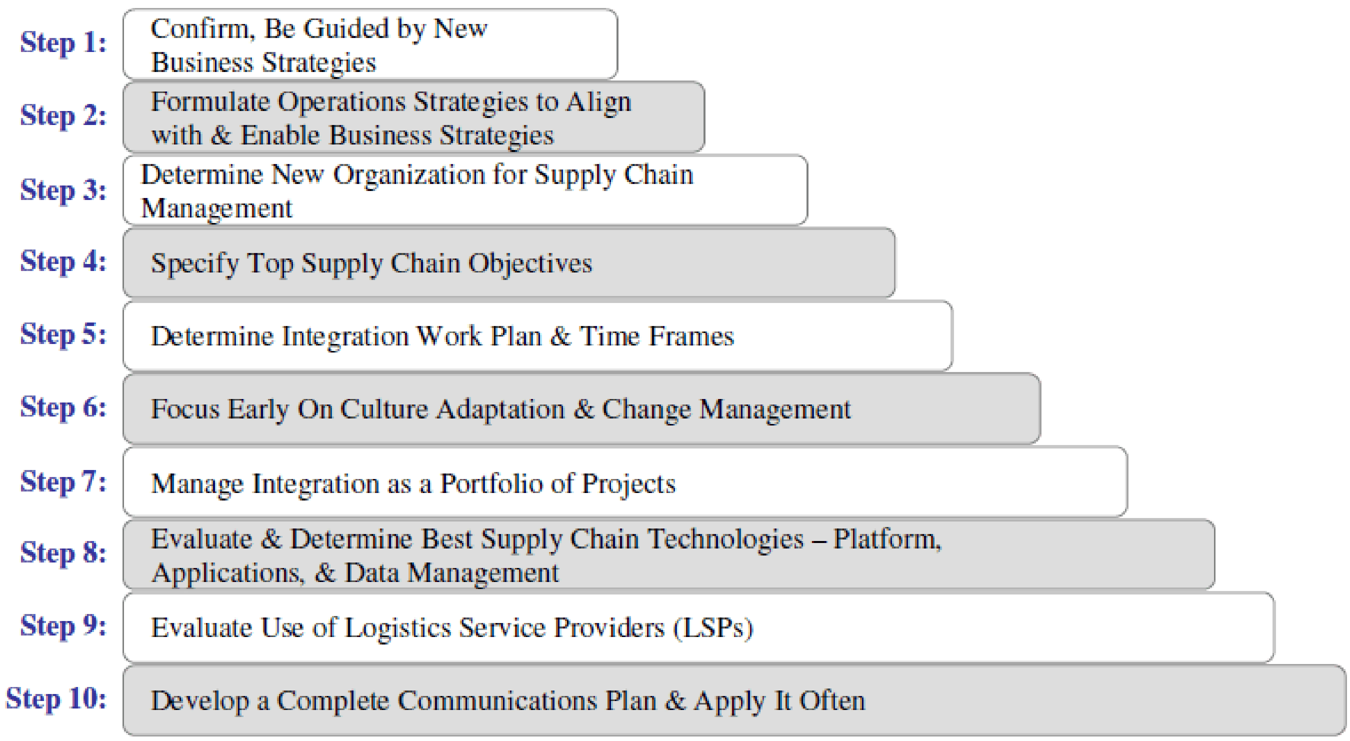

Figure 1. Steps To Achieve Effective Integration of Supply Chains

There are also other strategic questions and issues that are unique to the companies involved, and these should be sought out and understood as well. It is not essential that every strategic detail be internalized for the integration, as often these are evolving and will be defined as the combination unfolds. It is essential, however, that the strategic direction be clarified, validated, and understood by supply chain managers as they plan for the integration.

We are often asked by supply chain managers how they can become aware of these strategic goals early enough, when these are often deemed confidential at the Board and senior executive levels for both preferential and regulatory reasons. Our advice is that while compliance with regulations is, of course, paramount, the "need to know" is a matter of who is deemed critical for the evaluations. At the very least, the Chief Supply Chain Officer (CSCO) should be "at the table," and he or she should be allowed to involve their key reports on the planning teams, early on.

If the supply chains have been considered as important to the business case value, then the CSCO must be involved. Otherwise, supply chains could well be misunderstood, misrepresented, or undervalued. These negative effects will limit or constrain the expected business value of the combination.

Benchmarking Performance: The Supply Chain Consortium

Opportunities for benchmarking supply chain performance are often not well known or widely communicated, which limits the involvement of supply chain managers in the M&A process. An effective solution to this problem is provided by the Supply Chain Consortium (powered by Tompkins Associates), which includes almost 500 member companies across all industry segments.

Consortium members share performance data on their supply chains – everything from operations strategy, to organization, to key performance indicators (KPIs) across and deep into the entire supply chain. These provide a comprehensive repository of more than 17,000 benchmarks (and best practices) from which members can compare with best in class, best supply chains, or best in their industry segment. Tompkins also produces periodic "hot topic" reports that provide further information on matters of interest.

This comprehensive database of performance measures permits members (or Tompkins) to benchmark for opportunities and value potential. Whether involved in a company planning, considering M&A or another type of integration, or justifying a program of improvement, the Consortium can provide unmatched information on value-based opportunities.

Using this process smartly, and developing a value proposition around it, can often catapult the supply chain straight to the executive agenda for M&A.

For more details on the Consortium, visit: www.supplychainconsortium.com

Next, Operations Strategies

All too often, even though the business strategies can be identified and understood, supply chain managers launch too quickly into initiatives that appear to integrate the supply chains. In fact, they initiate actions that automatically focus on operational cost savings synergies without first considering what the operations strategies should be – and how these should align with the business strategies.

Surveys have shown that 9 out of 10 organizations fail to implement their strategies as intended. This surprising finding is based on several factors, not the least of which is the lack of alignment of operations with business strategies. With M&A activity, this issue can cause many such transactions to fail to live up to their stakeholder promises, which in turn creates a myriad of additional business problems.

Setting operations strategies, then, is much more important than is commonly understood. Again, if the business strategy is to compete as a low-cost supplier as well as a high-service provider, then supply chain managers need to figure out how to achieve both. If the business strategy is to enter more emerging markets, then supply chain managers need to determine how to do this efficiently and effectively. If the business strategy includes rapid new product introductions, then the supply chain managers need to figure out how to deliver these without the degradation of normal product ordering channels. And so on.

Figure 2 illustrates the common findings of surveys that strive to examine the business strategies for mergers and/or acquisitions. This graphic does NOT report on the percentage of achievement of these goals. As stated earlier, the achievement rate of implementing new business strategies is quite limited, which would raise the question of whether these goals are actually realized. The appropriate focus and commitment to setting and executing the right operations strategies is one key success factor.

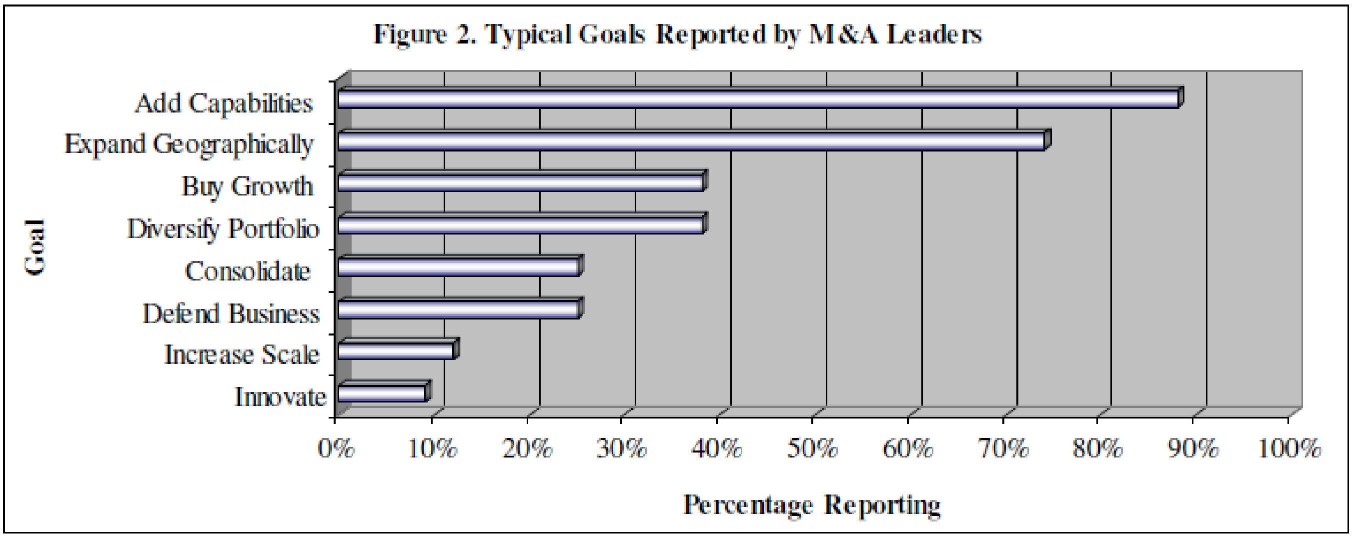

Figure 2. Typical Goals Reported by M&A Leaders

The principles and best practices for setting operations strategies include the following six steps:

1. Identify the business strategies that operations need to enable.
2. Formulate the strategic description of how the integrated supply chains will operate.
3. Determine the best supply chain strategies to meet the strategic operations goals, for example:
   - by geography;
   - by customer type and channel;
   - by product category;
   - by special needs such as new product introductions; and
   - by supply chain process: PLAN, BUY, MAKE, MOVE, STORE, SELL.
4. Assure that the respective supply chains can provide for these needs or what will be needed to transform.
5. Validate that the operations strategies will align properly with the business strategies.
6. Determine the right performance measures to track progress.

While these steps are not overly complex, they are often overlooked. This results in re-work and underperformance, and may even affect customer satisfaction.

Now, Determine New Organization

The common theme in most supply chain integrations is, "Let's first determine the new supply chain organization." Understandably, there is a tendency for people to be more often concerned about their positions, their titles, their responsibilities, and their lines of authority than they are about the business strategy and the operations strategies. Further, senior executives are interested in the financial effects on overall positions and productivity, so their directions are focused on the new organization. Getting to this decision too soon, however, and bypassing the above two steps, is a serious mistake.

Organization and structure follow strategy. Unless this principle is understood and followed, errors in organizational design are made that can cause underperformance at the very least, and serious supply chain disruptions at the worst.

” Organization and structurefollow strategy. “

Supply chain organizations can follow several different models, and this is especially true if cross-border supply chains are being integrated. When first planning the new organization, it is wise to assess the current structures – not just for names, titles, and charts – but for capabilities, competence, and performance. It is very likely that these will differ in their inclusion of processes, as well as their spans of control and divisions of responsibility and authority. This assessment step is critical to understanding how the current supply chains are planned, managed, and controlled.

Next, we need to consider the cultural factors – is the acquiring organization driving the culture, or is it meant to blend these? Is the management style planned to be “command and control,” “lean and mean,” team-driven, consensus-based, or what? Only then can we begin to design the preferred structure.

A tight, hierarchy-based structure will look somewhat typical with chains of command clear, while a matrix management structure will involve cross-functional managers and processes. And, there are several possible hybrid organizational models in between these two.

For supply chain management, we would expect to see – in a global or international organization – certain planning processes and process standards centralized globally. For regional organizations, all supply chain processes and tasks would be present; and for local organizations, processes and functions would be mostly facility-based.

Some key principles of supply chain re-organizations include:

- Evaluate the end-to-end process – from supplier’s supplier to customer’s customer.

- Ensure that the mega processes within this are integrated at some level.

- Think process, not department, office, or function.

- Think cost, time, and quality of the flows.

- Make certain all four flows are addressed in the design – physical, information, cash, and work.

- Set the right criteria for evaluating alternative designs. Base these on the business strategy, operations strategies, and key performance measures that will drive the value.

- Establish process teams to plan, evaluate, and decide on the preferred new organization(s) for the new supply chains.

The setting of appropriate performance measures (scorecards), or key performance indicators (KPIs), is often not considered in coordination with the new organizational design work. The principle and best practice, however, is to establish KPIs for the new organization design prior to the integration of the business processes.

Thus, the required KPIs for the new supply chain organization will serve to drive those that are established for the integrated processes. This directed alignment, then, will also help in making choices about the new processes.

Figure 3 illustrates the common categories of KPIs that are often adopted as overall measures of performance for the new supply chain. The range of measures within these is almost limitless. Metrics should be defined for the particular new supply chain organization, and the opportunity to design the right KPIs should not be overlooked.

Cost	Time	Quality
• Total Supply Chain Costs • Costs by Mega Process • Costs by Global, Regional, & Local • Costs by Account – Labor, Facilities, Expense, etc. • Costs for Outside Service Suppliers • Costs to Serve Customer Classes • Costs by Supply Chain (Product, Geography, etc.) • Information Technologies • Risk Management	• Cash-to-Cash • Total Supply Chain Times • Times for Global, Regional, Local Flows • Order to Delivery • On-Time Performance	• Perfect Orders • Process Accuracy • Forecasting Accuracy • Re-Work • Productivity • Supply Chain Visibility • Return on Assets • Information Accuracy

Figure 3. Categories & Examples for Setting Key Performance Indicators (KPIs)

Defining Integration of Processes

Whether or not the respective supply chains – for PLAN, BUY, MAKE, MOVE, STORE, AND SELL – are believed to be based on leading practices, and are performing at peak efficiencies, supply chain integration due to a business combination presents an opportune time to assess supply chains and identify the gaps in performance and/or capability. An objective assessment can be established by mixing the teams, assigning the best managers to the tasks, and evaluating the processes against available benchmarks.

There are five critical supply chain objectives that are typically specified in an integration driven by a business combination, and these depend greatly on the processes that will execute the operations strategies. These are:

1. **The synergies of supply chain cost reduction.** As mentioned earlier, these are more likely to be highlighted in today's M&A activity than ever before. Cost savings can accrue within each process – whether it is in buying, producing, assembling, moving, storing, or selling goods and related services. Costs of goods sold, costs to serve customers, freight expense, facilities costs – the list is long and powerful. The critical success factor is to find these, ensure they are not necessary for customer satisfaction or growth, and execute them correctly.

2. **The optimization of inventories.** Most companies continue to be challenged by forecasting, demand and supply management, and uncertainty. Despite consistent attempts to improve the process of Sales, Inventory and Operations Planning (SIOP), the optimal balancing of supply and demand remains elusive. There is some evidence that the supply chain integrations of merged companies have even created more inventories than was the sum of the two. The inability to get the SIOP process functioning effectively can result in excess inventories being created and then being deployed to the wrong locations.

3. **The value creation.** The effective integration of the supply chains involved in a business combination should lead to new values being created – not just for cost savings, but also for growth contributions. Depending on the business and operations strategies, the new supply chains should, for example, enable efficient entries to new emerging markets. In addition, the new supply chains should improve the supply base, enhance customer satisfaction, and improve operating performance when benchmarked against the competition.

4. **The rationalization of facilities.** This objective is often specified as a cornerstone of the integration, along with the common requirement to reduce full-time resources in a new organization. Here again, initiating this work too early, without full consideration of the business and operations strategies, can lead to operational issues. For example, the strategic goal "to reduce the number of distribution centers (DCs)" may, by itself, lead to wrong locations, inability to satisfy customer needs, or longer lead times. The best practice for this rationalization is to conduct a comprehensive review of current facilities, strategic needs, logistics flows, inventory policies, and alternative networks.

And then after the review, apply modern optimization modeling tools to help find the best solutions.

5. **Facilitate supply chain innovation.** It is not enough in today's highly competitive markets to be efficient; we must also be innovative in continuous improvement and in new services that are tailored to customers' unmet needs. Therefore, an important supply chain objective to be derived from the integration is to enable the new organization and processes to be recognized and rewarded for innovations such as:

    - Predicting future trends in supply chains;
    - Reducing time to market;
    - Leveraging new technologies and processes;
    - Securing support for investments; and
    - Identifying new customer behaviors or needs.

    " Coming up with the right idea at the right time and securing funding for it can often leap frog the company to new levels of advantage, performance, and value. "

While these innovations can be challenging, coming up with the right idea at the right time and securing funding for it can often leap frog the company to new levels of advantage, performance, and value.

Next, Integrate Technologies

One of the most difficult sets of decisions to be made involves technologies – which to retain, which to integrate, and which should go onto the capital expenditure budget. The decisions on ERP matters will be made by a number of stakeholders, but the decisions on supply chain applications and technologies are best left to supply chain managers. Technologies should be selected to help transform the processes to the desired vision, or future state. Thus, these decisions need to follow the plan for process integration.

While the primary technological issues are likely to be commonly centered on the larger systems, newer applications should also be identified. These include: transportation management systems (TMS); warehouse management systems (WMS); supply chain planning; global trade management (GTM); sales, inventory and operations planning (SIOP);

reverse logistics and service parts management (SMS); and more. When the situation arises that both merging companies have applications for one or more of these technologies, deciding which one “survives” becomes a challenging task. This is another reason why strategies, organizations, and processes need to be defined first – providing for the right criteria to be identified to evaluate the trade-offs.

A related point with respect to supply chain applications is that the requirements in developing countries will likely be different than those in mature markets, especially with TMS and WMS. Where volumes are lower, and the needs are less developed, Tier II applications can be evaluated; however, this choice is not straightforward either, as their ease of integration with global ERPs is an important consideration.

New platforms – such as “cloud computing,” software as a service (SaaS), and on-demand applications – should also be evaluated. If either company has experimented with these new options for a supply chain application, this learning can be valuable. Keep in mind, however, that these new technologies are expanding in interest and capabilities and may not yet be ready for larger companies with large data requirements.

A related, but equally challenging issue is data management. Proliferations of SKUs, parts numbers, bills of material, and international transactions have made data quality and data management a large enough issue for any one company. The integration of two companies supply chains will, of course, make this challenge even more complex. At the very least, a plan for master data management (MDM) needs to be developed for the merged supply chains.

” New platforms – such as “cloud computing,” software as a service (SaaS), and on-demand applications – should also be evaluated.”

Some prominent companies that have made acquisitions a core value – such as Cisco – have highly developed principles and practices for technology integration, as well as for organization and process standards. Most, however, do not have adequate experience and best practices for technology integration. The basic principle here is to first specify the information requirements – to enable the new organization and processes – then, set up the decision criteria for how these choices will be made. Process and technology teams should then be formed to assess, evaluate, and recommend the new portfolio and platform for supply chain management.

What About Logistics Service Providers?

It would be the rare case today for integrating companies to not have different strategies for logistics outsourcing, different service providers under agreements, and different performance scorecards for managing, monitoring, and correcting.

Of course, the initial task for this integration topic is to inventory all logistics service providers (LSPs) under agreements, the nature and location of their services, the provisions of their respective contracts, and the durations of each. This will determine the available flexibility for making changes that will be most likely required at some point.

Just as with the processes and technologies, the engagement of LSPs should follow and be aligned with the business and operations strategies. The planning, moving, and storing of goods (and associated information) is a key factor in the ability of supply chains to act with at least some flexibility and speed. The new supply chains will likely have somewhat different objectives and performance goals to achieve, and the LSPs need to help enable those.

Resolving strategic questions and differences about the engagement of LSPs should be handled under the charters of teams set up for this purpose. The assigned members should have basic knowledge of how LSPs work, how to learn their capabilities and weaknesses, and how they should best be managed and dealt with through relationships. Solid principles and best practices are available for these management tasks, and it is important to adapt these to the companies being combined.

Again, Focus on Culture and Change Management

We have all learned from numerous supply chain integration experiences – no matter how comprehensive the plan, how disciplined the integration process, and how rational the selection of best practices during the process – that all this is subservient to the issue of cultural integration. Unless this fact is recognized up front, and dealt with through proven methods, the supply chain integration – just as with the other integrations – will NOT meet the committed goals and value creation expectations. The more distinct the cultures and working habits of the respective supply chain organizations, then the more important this factor is to success.

Surveys have shown that cultural adaptation and integration are the dominant factors in determining the success of business combinations, and as much as 75% of the challenge. Change management programs need to be instituted early in the process, not after the fact; and, they need to be adapted to the assessment of change readiness of the respective supply chain organizations.

” Because cultural adaptation and integration are the dominant factors in determining the success of business combinations, change management programs need to be instituted early in the process. “

Despite its recognition, we see too few companies taking on the cultural and change issues up front and managing them through the integration. Supply chain leaders are no different than any others in the organization – they resist change. They are most comfortable with what they know, and not what they do not know; and they are functional and task-focused, rather than strategic or process-driven. Yet we know for certain that if change management lacks commitment and sponsorship from executive management, supply chains will not be improved or synergies achieved as expected or planned. *Figure 4* below illustrates the best outcomes.

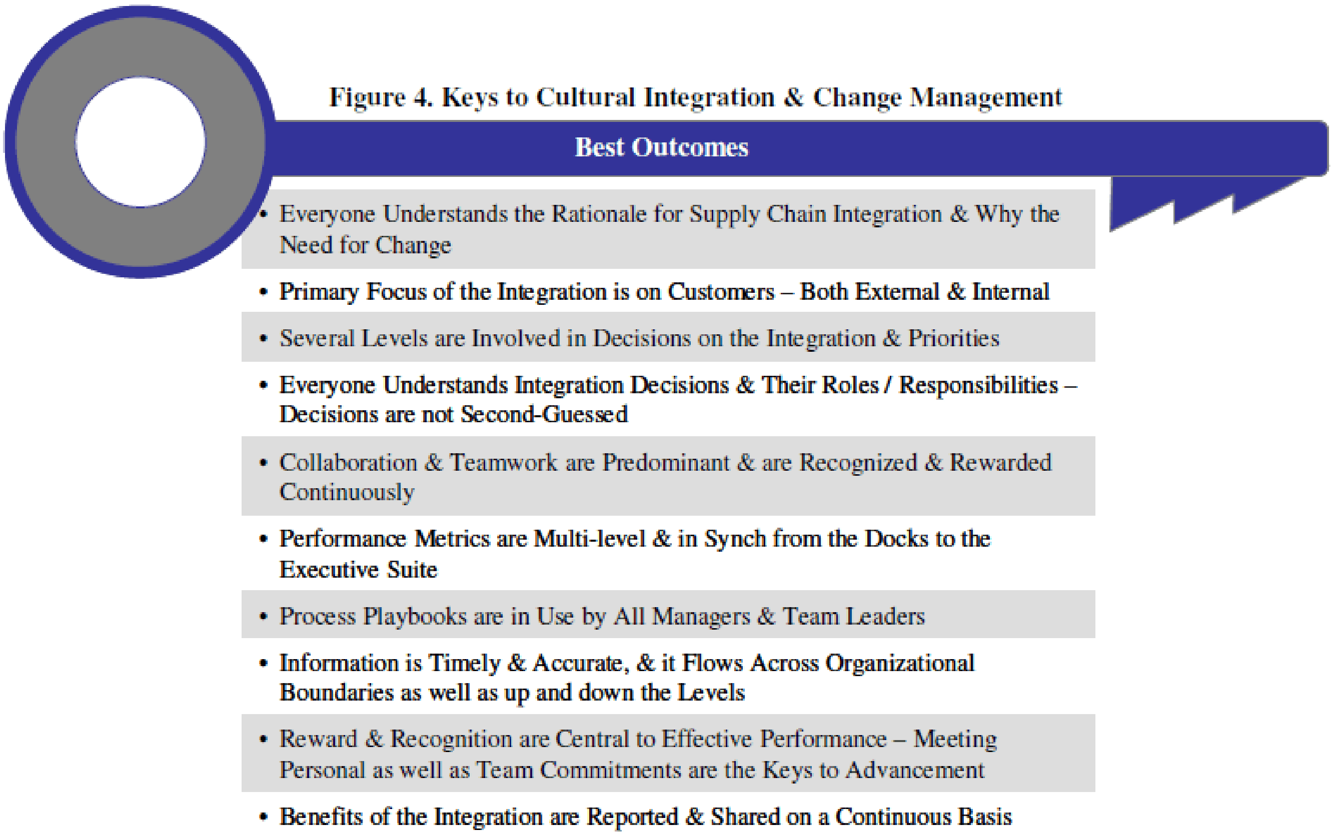

Figure 4. Keys to Cultural Integration & Change Management

Other Tips on Principles and Best Practices

Obviously, we cannot address here all the methods and models for resolving every supply chain integration issue or question. The identification of key principles and certain best practices will help guide the supply chain integration managers, and those addressed in the previous section are summarized in *Figure 5*. Beyond these, however, relevant experience and lessons learned will provide the right tips when progress slows, issues go unresolved, and misunderstandings surface during the work.

Operations Strategies	• Identify Business Strategies to be Enabled • Formulate Integrated Supply Chain Vision • Determine Best Overall Supply Chain Strategies • Validate These • Determine Project Teams
The Process	• Perform Cost Reduction • Optimize Inventories • Create New Value • Rationalize Facility Network • Facilitate Supply Chain Innovation • Use External Views To Help Decide
Culture & Change Management	• Build These Concerns in from Start • Develop & Follow-through with Communications Plan • Gain Continuous Learning & Adjust
New Organization	• Take a Process View • Address All Four Flows • Set Right Criteria for Designs • Factor in Talent Imperative • Establish Teams & Charters
The Technologies	• Assess Current Systems, Applications, Platforms • Evaluate Existing Applications, Uses • Establish Supply Chain Information Plan • Determine Master Data Management • Form Project Teams of IT/Users/Process Managers
Logistics Service Providers	• Inventory All Current Agreements & Plans • Determine New Outsourcing Strategies

Figure 5. Summary of Principles & Best Practices by Supply Chain Topic

Following are some additional guidelines that are associated with best practices in planning, managing, or achieving effective supply chain integration.

M&A is a tool, not a strategy. Many companies act as if an acquisition is its growth strategy, when in fact, unless the supply chain integration is done effectively, value is not created. Further, the acquisition is a method to achieve a business strategy, not a strategy on its own. What this means for supply chain managers is that, again, the integration must be an enabler and aligned with the business and operations strategies. This critical point must be reinforced through communications on a continuous basis.

Identify the strongest people and teams. Inasmuch as the vast majority of combinations have the primary goal of adding capabilities, the supply chain managers for integration cannot lose sight of the talent imperative. Expanding geographically and increasing scale are worthy goals, but without improved capabilities, these will not be achieved. Thus, supply chain integration, again, should provide for cross-company assessments, and the identification of the strongest people and teams. Only this outcome will yield true competitive advantage.

Speed to integration must be balanced with time to reflect on and absorb integration- specific learning. This guideline seems to be common sense; however, it is all too often weakened or ignored by board or other stakeholder pressures for early synergies, for rapid change, and for payback. Supply chain managers should plan for necessary time to change, to learn, and to sustain; then determine how to convince executives that time is needed to maximize the benefits. Effective project management methods will go a long way to convince others that progress is being made, on-time and on-plan.

Develop and execute a strong communications plan. The value and requirement for comprehensive and continuous communications deserves mention once more. Once the business combination is announced, anxieties increase and disruptions become a major risk. Studies have shown time and time again that non-productive activities expand dramatically when communications are limited. Further, the opportunity for misinformation, and even confusion, is at its highest when major organizational actions are underway. It is essential that a strong communications plan be adopted and executed before, during, and following the integration.

Always think of the customer. When issue discussions reach stalemates, and teams are unable to resolve choices, the best solution is to turn toward the external environment – customers, competitors, trading partners, regulators. How would customers benefit? Which way is best for them? Which path will create more advantage for us? Often, internal thinking and criteria can lose sight of the ultimate objectives: better supply chains for better customer satisfaction.

View the supply chain integration continuously as the opportunity to know the entire company better and apply that knowledge productively. In the normal course of business, managers are busy with their own jobs, collaborating and cooperating only when necessary. Integrating supply chains presents the opportunity to learn the other processes better – financial, sales and marketing, R&D, etc. – so that the resulting supply chains are not only performing better, but they are better understood for their value to the overall business.

Conclusion

The effective integration of supply chains requires a comprehensive agenda and skilled team leaders. But most of all, supply chain integration demands the adherence to sound principles and best practices.

There are many factors involved in making the difference between a healthy combination and a mediocre one, and there are substantial variables that cannot be predicted accurately. Without a principled approach, and knowledge of what works well, supply chain integrators will stumble, deal with friction, and get stuck frequently.

Many supply chain integrations extract short-term financial synergies efficiently, but ultimately fall short of creating high-performing supply chains that lead to sustained value for customers and stakeholders. “

Many supply chain integrations extract short-term financial synergies efficiently, but ultimately fall short of creating high-performing supply chains that lead to sustained value for customers and stakeholders. The pressure for short-term cost savings can be intense, and supply chain managers are too often directed toward these at the expense of higher value.

The imperatives for true and lasting success with supply chain integrations are few; yet their achievement is challenging. The real keys to success in integrating supply chains in M&A are:

- Assign strong and experienced team leaders;
- Focus on enabling the business and operations strategies;
- Decide on the new organization and processes with the right criteria;
- Apply sound principles and best practices to all the work; and
- Establish a performance-based culture and a self-assessing DNA.

As it is with planning and achieving supply chain improvements in general, the integration should follow established work approaches and processes. Supply chains are increasingly finding themselves in competition with each other, rather than companies competing with each other. This trend in itself should motivate companies to get the supply chain integration right, make it sustainable, and create value.

Contact Information

Gene Tyndall
EVP, Global Supply Chain Services
Tompkins Associates
gtyndall@tompkinsinc.com

About Tompkins Associates

Tompkins Associates transforms supply chains for profitable growth. For more than 35 years, Tompkins has evolved with the marketplace to become the leading provider of growth and business strategy, global supply chain services, distribution operations consulting, information technology implementation, material handling integration, and benchmarking and best practices. The company is known for innovative, practical solutions that improve supply chain performance and produce value-based results. Headquartered in Raleigh, NC, Tompkins has offices throughout North America and in Europe and Asia. For more information, visit www.tompkinsinc.com.

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